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International Economic & Energy Weekly [redacted]

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21 September 1984

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International Economic & Energy Weekly

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International Economic & Energy Weekly 25X1

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Ivory Coast probably will record its third consecutive year of declining GDP in 1984. Weak markets for major exports, mushrooming debt payments, public-spending cuts, and shortages of vital imports probably will cause another drop in 1985, when President Houphouet Boigny must seek reelection. 25X1

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Perspective

LDC Debt at the IMF/IBRD Annual Meetings [redacted] 25X1

The world debt situation will be a major topic at the joint annual meetings in Washington of the IMF and IBRD, which begin on 24 September. Much of the discussion will occur outside the regularly scheduled meetings. These informal gatherings have produced significant results in the past. At the 1982 annual meetings in Toronto, for example, the details of Mexico's financial rescue package were worked out. [redacted] 25X1

The centerpiece of the discussion will be the current debt strategy and the need for alterations to permit growth and longer term recovery. Most creditors will state that the immediate crisis—the threat to the stability of the international financial system—has passed and that the current strategy is working. The debtors, however, will claim that a number of problems remain. Although creditors have adopted a medium-term approach to deal with the burden of principal repayments, most banks are reluctant to lend large amounts of new money for development needs, even to countries such as Mexico and Brazil, which have complied with their IMF-supported programs. With a large share of current export earnings being applied toward interest payments, debtors are concerned about future economic growth prospects. [redacted] 25X1

In addition to seeking greater new lending from commercial banks, which hold nearly two-thirds of LDC debt, debtors will push Western governments, the IMF, and the World Bank for increased assistance. Latin American debtors have been the most vocal on this subject, particularly after the Cartagena meeting in June. These countries—most notably Argentina—are proposing a joint conference of creditor and debtor nations in an effort to politicize the debt issue and put greater pressure on commercial banks to be less stringent on financial packages for troubled debtors. [redacted] 25X1

For their part, the IMF and the IBRD will examine additional ways of assisting debtors. Proposals that will be discussed by the IMF include:

- An extension of the enlarged access facility, which is supported by most industrial countries.
- A new special fund for countries hard hit by rising world interest rates.
- A new issue of special drawing rights (SDRs), a move favored by the French.

The World Bank will debate whether more of its loans should be oriented to general programs as opposed to being strictly tied to specific projects. [redacted] 25X1

A related area of discussion concerns actions that could be taken to restore LDC growth. This question will not be resolved at the IMF/IBRD annual meetings, but the opportunity exists for creditors and debtors to move beyond immediate repayment problems and into issues of long-term development, such as greater investment flows, reduced barriers to trade, and private-sector revitalization. Consideration of these issues would be a positive sign that creditors and debtors recognize the need to shift into the next phase of the debt problem. [redacted] 25X1

[redacted] 25X1

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Briefs

Energy

Libyan Oil Barter Deals

[redacted]

Tripoli increasingly is trying to pay for essential imports with crude oil. 25X1 [redacted] 25X1

We estimate that about 40 percent of Libya's current oil exports of about 1 million barrels per day is shipped under barter arrangements. Libya's national oil company, however, is having difficulty expanding small barter exchanges and offshore processing agreements because of the oversupply of crude in West European markets, and Western contractors increasingly are resisting accepting oil for their services. [redacted] 25X1

Libyan Pipeline Explosion

[redacted]

Libya's export terminal at Marsa el Brega reportedly has been shut down since late August by an explosion and fire on a dual-use crude and natural gas pipeline from the Zelten field to the terminal. The pipeline had been transporting over 100,000 b/d of oil along with associated natural gas, and its shutdown is part of the reason Libyan oil production probably will average only 900,000 b/d in September. The pipeline should return to operation in October. [redacted] 25X1 25X1 25X1

[redacted] Deferral of maintenance and repair because of budgetary constraints has caused widespread deterioration in Libya's petroleum production and transportation equipment in recent years, and we expect continuing problems in Libya's oil production and transportation system. [redacted] 25X1

[redacted]

Czechoslovakia Purchases Refining Technology From Western Europe

[redacted]

In early August, Czechoslovakia signed contracts with Austrian, West German, and Italian companies for licenses to manufacture petroleum refinery hydrocracking equipment. Hydrocracking is a sophisticated refining process used to convert heavy fuel oil into lighter products such as gasoline, kerosene, and diesel fuels. There currently are no hydrocracking units in Czechoslovakia's petroleum refineries, and until now the Bloc countries have not had the technology to construct hydrocracking units. In addition to upgrading Czechoslovakia's petroleum refining industry, the purchase is significant because Czechoslovakia is one of the largest suppliers of petroleum refining equipment to the Soviet Union. The Soviets have been attempting—with little success—to construct a hydrocracking unit in one of their refineries since 1976. Hydrocrackers would help the Soviets accomplish their goal of increasing the production of light petroleum products, without correspondingly increasing crude oil production. [redacted]

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International Finance

Status of Philippine Financial Rescue Package

[redacted]

Manila's efforts to assemble a financial rescue package are focused on concluding difficult negotiations with its commercial bankers. The IMF's executive directors cannot approve the Fund's proposed $630 million standby loan without assurances that $4.3 billion in new financing—$2.65 billion from official sources and $1.65 billion from commercial bankers—will be available for Manila's loan arrearages and 1985 foreign exchange requirements. [redacted]

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[redacted]

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European Currency Unit Redefined

[redacted]

EC finance ministers meeting in Ireland last week decided to incorporate the Greek drachma into the basket of currencies that make up the European Currency Unit (ECU). Because Greek inflation is running more than 10 percentage points above the Italian rate—the next highest in the EC—Athens

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did not join the intervention mechanism of the European Monetary System (EMS). As expected, the finance ministers adjusted the ECU basket to reduce the weights for the West German mark, the Dutch guilder, and the Belgian franc; the weights for the French franc, the British pound, the Italian lira, and the Irish punt were raised. None of the EMS currencies was devalued or revalued against the ECU, which is worth about $0.75. [redacted] 25X1

The change in the ECU probably will have little effect on the foreign exchange and the Eurobond markets. The change in weights means that the EMS countries with smaller weights can let their currencies deviate slightly more from parity before being obliged to take action, while those with higher weights will have to intervene earlier. Yields on ECU bonds probably will be slightly higher because the greater weight for currencies with higher inflation rates makes the ECU riskier. [redacted] 25X1

Global and Regional Developments

Reduced Sugar Earnings For Latin America

[redacted]

New US sugar import quotas—which call for a 16-percent cut from 2.76 million metric tons—will hit the Dominican Republic, Colombia, Peru, Brazil, and most of Central America especially hard. These countries depend on sugar sales as a main source of foreign exchange and on the US market as their primary outlet. The Dominican Republic, for example, will lose about $65 million—8 percent of 1983 export earnings—because reduced quota shipments will garner only about 5 cents per pound on the world market rather than the 21 to 22 cents guaranteed under the US sugar program. [redacted] 25X1 25X1

World sugar prices—currently at their lowest level in 15 years—are expected to remain extremely weak because of the expiration of the International Sugar Agreement and large sugar stocks that continue to overhang the market. Unless global production is cut sharply through acreage reductions or by a series of poor growing seasons, low world sugar prices are likely to persist for some time to come. Once again, this year's crop is growing well and is expected to exceed consumption by about 2 percent. [redacted] 25X1

EC Wheat Exports May Rise

[redacted]

Because of a bumper wheat crop this year, the EC is under pressure to increase worldwide wheat exports. The EC Commission estimates that 1984 Community production may reach 69 million metric tons, about a 17-percent jump over last year. Under the EC's Common Agricultural Policy, the Community normally subsidizes its exports by offering "refunds" to wheat exporters to offset the difference between high domestic support prices for wheat and generally lower world market prices. Largely because of the strong US dollar—the currency in which world grain trade is conducted—EC and world wheat prices are converging, and, as a result, the Community probably will begin to export unsubsidized wheat this month. Commission officials maintain that the self-imposed 14-percent market share that the EC has adhered to in recent years does not apply to unsubsidized wheat sales. [redacted] 25X1 25X1

EC Budget Crisis Eases

EC members are nearing resolution of their short-term budget problems. The United Kingdom apparently has dropped its opposition to EC loans from member states to cover the EC's estimated $1.5 billion budget shortfall. In return, other EC members will agree to new directives aimed at controlling the growth of EC agricultural spending. The ministers also discussed moving up to next fall the implementation of new revenue measures originally scheduled for 1986. Although these arrangements—which probably will be finalized at Council meetings in early October—should put the Community's financial woes to rest for a year or two, the EC almost certainly will encounter renewed difficulties when revenues again run low in 1986 or 1987.

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Japanese Buy Grain From China

China has sold 150,000 tons of corn to three Japanese firms in the first grain deal between the two countries. The Chinese contend that increased Japanese purchases of agricultural products would help boost Chinese imports of Japanese machinery and technology. Press sources report that the Japanese are proceeding cautiously because of fears that increased purchases from China would arouse opposition from Washington and from Japan's major suppliers in the United States.

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Possible Reappointment of UNCTAD Secretary General

The US Mission in Geneva reports that UNCTAD Secretary General Gamani Corea may be picking up Third World support for another term in office. UNCTAD is a forum for North-South economic negotiations, and Corea has helped give it a pro-Third World bias. If reappointed for another five-year term in December, he probably would try to stymie the US-sponsored effort to reform the organization. UN Secretary General Perez de Cuellar has the authority to nominate a candidate for the post but is allowing the developing countries to make the choice. The developing countries, however, have been unable to settle on a new candidate and may ask Perez to renominate Corea.

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National Developments

Developed Countries

New Israeli Economic Measures

At its first Cabinet meeting on 16 September, Israel's new national unity government approved in principle a $1 billion cut in the national budget, devalued the shekel by 8.3 percent, and increased fuel prices by 9 percent. Other elements of the government's economic plan have not been decided, but some ministers predictably are protesting proposed cuts in their particular budgets. By these early proposals, Prime Minister Peres hopes to signal to both the Israeli public and the United States that the Israeli Government is serious about dealing with the ailing economy. No enforcement mechanism, however,

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has yet been devised for the new proposals. It is also unlikely that the new government will tackle the structural problems at the root of Israel's economic crisis, particularly the indexation of wages to the inflation rate and the absence of effective monetary policies. 25X1

Japan Seeking To Develop New Ceramics Technology

MITI has announced a six-year $125 million R&D project that includes development of advanced technologies for making ceramic parts. The proposed R&D thrust—using high-energy beams to finish (cut and shave) ceramics parts—exceeds the technical scope of MITI's ongoing Fine Ceramics Project 25X1 and would be the first major effort of its kind worldwide. The new technology could be markedly superior to current mechanical finishing technologies, primarily diamond grinding, that often weaken ceramic parts and could bring closer the commercial use of precision ceramic parts in equipment such as automobile engines. 25X1

South African Gold Miners' Strike Ends

Mineowners and black miners this week agreed to a 4-percent real wage increase, ending a violent one-day walkout by half of the blacks at eight major gold mines. The compromise left them still earning only one-fifth as much as white miners, but represented an important victory for the new National Union of Mineworkers. Mineowners had originally offered a 2-percent real wage increase and insisted they would fire striking miners. This was the first 25X1 legal black miners strike under labor reform laws passed in 1979, and we believe it will boost the membership of the NUM, which now represents less than 20 percent of South Africa's black miners. Wildcat strikes have continued at mines not covered by the settlement. 25X1

Spain Eases Monetary Policy

Major Spanish banks, following discussions with the government, have agreed to lower their prime rates 1.5 percentage points and deposit rates 1.75 percentage points. To accommodate the lower interest rates, Madrid is 25X1 permitting somewhat faster monetary growth. With the inflation rate slowing from about 12 percent last year to 9.2 percent this summer, the current account swinging into surplus, and domestic demand slackening, the Socialists clearly believe that they have enough leeway to ease their monetary policy without jeopardizing the accomplishments of their austerity program. The Gonzalez government is seeking to reverse an average annual decline of 2 percent in real investment and average annual job losses of 260,000 from 1975 to 1983. While investment in some interest rate–sensitive sectors such as construction and automobiles may pick up, we do not expect the financial agreement to greatly influence most firms' investment decisions. 25X1

New Zealand Economic Summit

A three-day economic summit of representatives of government, business, and labor last week produced a show of consensus that would have been unattainable in the polarized atmosphere of the former National Party government of 25X1 Robert Muldoon. Union representatives, claiming that the longstanding wage freeze has led to greater income inequality, gained promises of speedy relief for lower paid and unemployed New Zealanders and a greater bargaining role for labor in the wage-fixing process. In wage negotiations, labor agreed to a government proposal to replace national awards with enterprise- and industry-level settlements. The government also indicated that it would relax price and wage controls as soon as the new budget is presented on 8 November. The durability of the accord is open to question, however, in view of strong opposition within Lange's Labor Party to his desire to reduce government intervention in the economy. [redacted] 25X1

Less Developed Countries

Chilean Payments Pressures Intensify

[redacted]

In responsc to a soaring current account deficit—$250 million above IMF program limits in the first half of 1984—Finance Minister Escobar on Monday announced a 24-percent devaluation of the peso and a uniform tariff of 35 percent. The Chilean Government has pledged to get its IMF stabilization program back on track by slowing economic growth [redacted] Santiago has responded slowly to IMF calls for austerity, fearing that it would provoke more opposition to the government. After the failure of a recent antiregime protest, however, President Pinochet apparently is willing to make unpopular economic adjustments. [redacted] 25X1 25X1 25X1

The effects of the latest measures will not be felt until next year. Santiago faces a balance-of-payments shortfall this year of $500 million and, by using some foreign exchange reserves to reduce the deficit, will not meet its IMF reserve target. Commercial bankers and the IMF may respond by suspending the $300 million remaining in current loans. Chile probably will appeal to major banks for a short-term loan until a new IMF agreement can be worked out. If bankers refuse, Chile probably will suspend its payments on the foreign debt. [redacted] 25X1

Bangladesh's New Land Reform Program

[redacted]

Dhaka has decided to implement a new land reform program to increase farm productivity, reduce the inequality in landholdings, and improve the regime's popularity with rural voters before national elections in December. On the basis of recommendations of the longstanding Land Reform Commission, the government plans to reduce the ceiling on family landholdings from 12 to 8 hectares and entitle sharecroppers, who constitute about 35 percent of the nation's farmers, to gain occupancy rights for up to five years. In our view, the modest reforms are unlikely to achieve their development objectives because they offer few major changes, will be difficult to administer, and can easily be subverted by landlords. [redacted] 25X1 25X1

Gloomy Appraisal of Indian Payment Prospects

India's central bank, in contrast to its moderately optimisitc report last year, now expects no significant new oil discoveries that could help lower India's oil import bill over the next several years. The bank noted that Indian repayments

[redacted]

due the IMF and commercial banks will rise through 1989 and expressed concern that greater competition from developing countries will lead to slower growth in export earnings. The central bank sees little prospect for increased foreign aid or private remittances and recommends intensified export promotion efforts instead. The government's highest economic policy body earlier this summer issued a similarly pessimistic analysis and recommended import restraints as part of India's 1985-90 Five-Year Plan. Prime Minister Gandhi is unlikely to make any major policy changes until after national elections, which must be held by January 1985, but we believe the February 1985 central government budget and April 1985 annual trade policy will include new proposals to forestall severe payment problems. [redacted] 25X1 25X1

Communist

Eastern Europe's Growing Trade Deficit With the USSR

[redacted]

Eastern Europe's trade deficit with the USSR rose to $1.4 billion in the first half of 1984, according to Soviet statistics. This is the largest gap at midyear since the record deficit of 1981 and runs counter to reports that Moscow no longer is willing to tolerate CEMA members' large trade deficits. Czechoslovakia and Hungary registered the largest increases, with imports growing twice as fast as exports. East Germany was the only exception. [redacted] 25X1 25X1

The rise in the deficit mainly reflects increasing costs of Soviet energy deliveries and slowing growth of East European exports to the USSR. Nevertheless, the deficit for the year still may fall below last year's level of $2.2 billion if Moscow is successful in prodding the East Europeans to meet export commitments. While the USSR probably will tolerate trade deficits in the short run, it probably will push harder to reduce or eliminate the deficits in 1986-90 trade plans. [redacted] 25X1

Eastern Europe–USSR Trade, January-June 1983 and 1984

Million US $

	Exports			Imports			Balance	
	1983	1984	Percent Change	1983	1984	Percent Change	1983	1984
Total	**18,524**	**20,470**	**10.5**	**19,518**	**21,914**	**12.3**	**−995**	**−1,444**
Bulgaria	3,472	3,810	9.7	3,887	4,283	10.2	−415	−474
Czechoslovakia	3,733	4,043	8.3	3,853	4,516	17.2	−121	−472
GDR	4,356	5,090	16.9	4,482	4,835	7.9	−127	255
Hungary	2,545	2,756	8.3	2,646	3,058	15.6	−101	−304
Poland	3,215	3,501	8.9	3,502	3,935	12.4	−289	−435
Romania	1,204	1,273	5.7	1,146	1,285	12.1	58	−12

[redacted] 25X1

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Western Europe's Airbus Industrie: Pan Am Deal Will Spawn Further Success [redacted]

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The Pan Am–Airbus Industrie agreement announced last week adds significantly to Airbus's worldwide prestige, and makes additional sales of the all-new, 150-seat, narrow-body A320 design much more likely. If the Pan Am board approves, and if all options are exercised, the agreement could involve 91 aircraft valued at some $3 billion, according to Airbus. The deal will benefit both parties; it removes Airbus's inventory overhang of widebody designs and increases the consortium's ability to develop a "family" of aircraft. In turn, Pan Am gains a quick increase in passenger capacity with a minimum financial commitment. Although the deal involves both wide-body and narrow-body aircraft, the strongest implications for the United States stem from the A320 sale—aviation experts believe the 150-seat market should total 2,300 aircraft, worth $70-75 billion during 1986-2000. [redacted]

The Airbus A320 Design at a Glance

According to Airbus Industrie officials, the basic A320 design concept is targeted for low-density, medium-range routes in Western Europe. We believe, however, that even in the conceptual stage Airbus designers were looking at markets around the world, especially in the Third World. Airbus officials indicate that two models are contemplated: a 100 series that offers a range of 1,800 nautical miles (nm) with 150 seats and a 200 series that offers a 2,100-nm range. [redacted]

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The Airbus Industrie consortium—France, the United Kingdom, West Germany, and Spain—manages the program. France is the driving force, with Aerospatiale as the systems integrator as well as manufacturer of the front fuselage, flight deck, center wing box, and engine nacelles. British Aerospace builds the wings, Deutsche Airbus the fuselage and tailfin, and CASA of Spain the horizontal stabilizer and landing gear. Power plants will be supplied by International Aero Engine Co., a consortium with Pratt Whitney, Rolls-Royce, Japan Aero Engine, Motoren und Turbinen Union, and Fiat, or by CFM International with General Electric and SNECMA as members. [redacted]

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The Deal

The massive Pan Am–Airbus agreement covers up to 91 aircraft: the purchase of 28 Airbus Industrie jets, the lease of another 16, and options on 47 more. The 28 aircraft Pan Am will purchase include both A310s and A320s; delivery is scheduled to begin in 1987. In the interim, Pan Am will lease 12 A300s and four A310s. These aircraft are available immediately. Over the longer term, Pan Am also has an option to buy 13 additional A310s and another 34 A320s. [redacted]

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Although specific terms of the purchase and leasing agreements were not disclosed, [redacted] Pan Am will make an initial $22 million payment to Airbus by yearend. The overall deal is set forth in a letter of intent that is subject to final approval by Pan Am's board. The transaction also depends on the carrier's winning favorable contracts with its labor unions. Each of the wide-body Airbus jets costs between $40 million and $50 million. The narrow-body A320 is priced at $26 million, according to Airbus. [redacted]

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The deal provides both parties with immediate benefits: the interim lease reduces Airbus's inventory at the main assembly plant in Toulouse, France. Because of an increase in production to some five units a month and a slowdown in orders,

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the consortium currently has an inventory of 26 unsold aircraft—known in the industry as "white-tails." For Pan Am, the lease provides a quick capacity increase until the newer planes are available. The leased planes will be returned as the A310-300s are delivered. The A320s will be used primarily to replace Pan Am's fleet of Boeing 737s on domestic routes and on its flights to West Berlin. [redacted]

The Competitive Landscape

Airbus believes the Pan Am deal enhances the competitive position of the consortium's aircraft and justifies the decision earlier this year to launch the A320. The new 150-seat aircraft is scheduled to be available in mid-1988—at least a year earlier than any all-new US design. The consortium believes the new-technology A320 will sell well against US manufacturers now offering only derivatives of existing aircraft—primarily the MD-80 from McDonnell Douglas and the Boeing 737-300/400. Airbus believes that the McDonnell Douglas decision to delay concept work on several new designs makes it unlikely that the US firm will build its own all-new design—the D3300. Moreover, Airbus has said that even if Boeing goes ahead with its all-new design, the 7-7, the A320 will retain its competitive edge, since the 7-7 will not be ready until mid-1989. [redacted]

150-Seat Aircraft: The Next Big Market

Aviation analysts in the United States and Western Europe believe that demand for new aircraft will center on the 150-seat, narrow-body sector of the market.[1] Aviation experts believe these aircraft will account for some 2,300 sales between 1985 and 2000. The United States will account for 45 percent of these sales, Western Europe 25 percent, Australia, Canada, and Japan 10 percent, with the remainder in the Third World. Most of the demand comes from replacements for existing aircraft, which industry analysts expect to reach about 1,600 aircraft. In addition, another 700 units will be needed to meet growth in traffic. [redacted]

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The Sales Push

Pan Am's acquisition of the entire mix of aircraft currently manufactured by Airbus will give a boost to the consortium's worldwide marketing efforts. The Airbus consortium has always placed special importance on the North American market, and we believe the Pan Am agreement is already generating additional targeting of US airlines. [redacted] We expect a particularly aggressive effort to sell the A320 to Delta and United. Delta was one of the first airlines to recognize its requirements for a 150-seat-aircraft design. Pan Am's intent to use A320s on its domestic routes will increase pressure on other US carriers to upgrade their fleets. [redacted]

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Elsewhere we believe Airbus will continue to press for sales to Western Europe's major carriers and to key airlines in the Third World. On the basis of our [redacted] assessment of current aircraft fleets, we believe West Germany's Lufthansa and British Airways are primary targets for sales. In the Third World, we believe Airbus will concentrate initial sales efforts on past customers for the A300/A310. [redacted]

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Order Book and Government Support

The A320, with its 152 sales and options, reflects the increased acceptance of Airbus by airline companies. The consortium had only a dozen orders for the A300 when it first flew in 1972; there was an unsold inventory of some 50 units in 1976. Massive financial support by France and West Germany kept the consortium active until A300 sales picked up in 1977. The same pattern of

[1] The designation "150-seat" is a generic term being applied to short-to-medium-range aircraft with 130 to 170 passengers. [redacted]

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government support underpins the A320.[2] The approximate $2 billion cost of A320 development is heavily underwritten by the governments of the consortium members.

New Airbus Designs

The Pan Am deal is likely to spur Airbus to expand its product line, thus enhancing its capability to compete with US manufacturers. The A320 itself will evolve into a series of derivatives with various capacities and ranges. Moreover, decisions may be speeded up for other wide-body designs: the TA-11, a four-engine 225-passenger wide-body aircraft for transoceanic operation; TA-9, a stretched version of the A310; and the TA-12, a long-range twin-engine aircraft.

Outlook

Airbus consortium initially set a goal of attaining a one-third market share with each of its designs. With the focus now centered on the 150-seat market, we believe the Pan Am buy of the A320 virtually guarantees this goal and sets the stage for an even-higher Airbus share of this market. Although the agreement is characterized as a "$3 billion sale of the century," its details have not been publicized. It does contain "escape" clauses that will allow Pan Am to react to market demands or to other airframe manufacturers if they offer an attractive all-new aircraft design. The events of the next six to 12 months will shape the total contract and determine the future of the A320 and the long-term winners in the 150-seat market. If US manufacturers cannot respond to the challenge posed by Airbus, the industry faces the loss of more than $1.5 billion in annual sales beginning in the late 1980s. 25X1

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South Korea: Foreign Investment Liberalization [redacted]

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Seoul has adopted new foreign investment regulations that are designed to attract advanced technology from abroad and reduce reliance on foreign borrowing. The revised rules, which took effect 1 July, open numerous areas for foreign investment and streamline the approval process. Foreign investors should find increased opportunities, particularly in the electronics, machinery, and transportation industries, the areas where frictions between Washington and Seoul over investment issues have been most pronounced. [redacted]

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The Liberalized Foreign Investment Policy

Revisions to the Foreign Capital Inducement Law (FCIL)—which has governed foreign investment since 1962—eliminate most barriers to direct foreign investment by:

- Allowing foreign investment in all industries except those specifically proscribed by Seoul. Previously, investment was allowed only in industries specifically identified as eligible.
- Replacing the requirement for prior approval for technology transfer with an after-the-fact notification system.
- Increasing the overall share of industrial sectors allowing foreign investment from 44 to 67 percent. [redacted]

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We believe that the new system of listing only those industries specifically closed to foreign investment should clarify murky guidelines and will permit investment in previously restricted areas. Seoul is placing a high priority on attracting investment in high-technology sectors, and many formerly restricted areas—such as magnetic-storage media for computers, steam and gas turbines, and industrial robotics—are now open to foreign investment. [redacted]

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Industries Closed to Foreign Investment by Inclusion on the Negative List

Of the 272 sectors closed to foreign investment, 82 have been designated as closed for the indefinite future. The remaining 190 sectors may be opened to foreign investment in the future or, in extraordinary circumstances, may be reviewed on a case-by-case basis for foreign investment at any time. In publicly justifying the "restricted" category, Seoul has characterized the industries included as those which:

- *Receive special government assistance (such as subsidies or support for basic research).*
- *Generate pollution.*
- *Depend heavily on energy and/or imported materials.*
- *Encourage consumption of luxury goods.*
- *Adversely affect the farm and fisheries sectors.*
- *Involve simple personal and household services.*
- *Are infant industries for which protection is necessary for the near term.*

Seoul has announced that it will update the negative list every six months with the intention of reducing its size. [redacted]

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According to US Embassy reporting, jockeying over the final version of the negative list continued until its release on 27 June. Changes from an earlier draft suggest that the influence of the officials favoring liberalization was strong: sectors that would benefit from innovation and technological upgrading were removed from protection, while sectors less attractive to investors with limited opportunities for technology transfer were added. [redacted]

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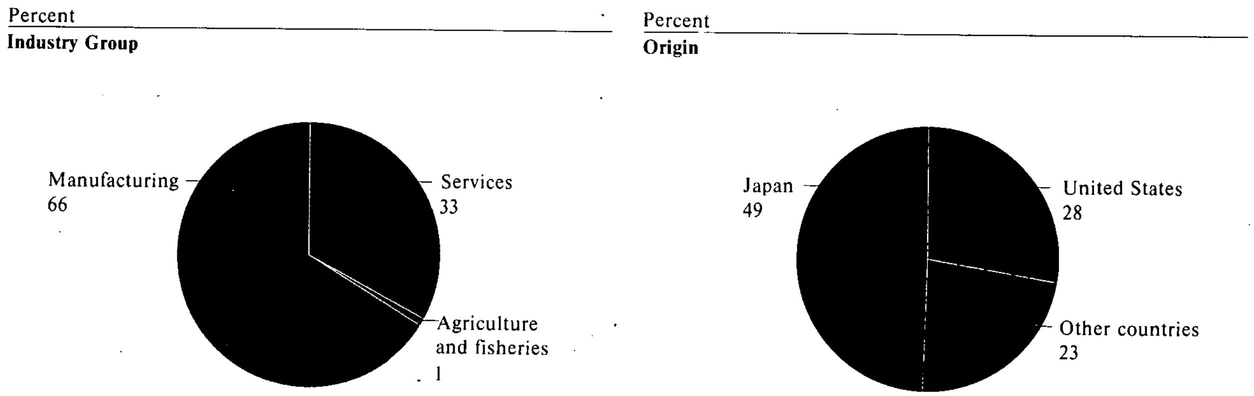
South Korea: Cumulative Direct Foreign Investment Approvals, 1962-83



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Manufacturing-Sector Benefits

In the manufacturing sector, foreign majority ownership is allowed in 84 percent of all industries, compared with 15 percent previously, and restrictions on foreign equity shares that affected 52 percent of manufacturing industries have been abolished. The number of manufacturing areas in which foreign investment of any kind is prohibited is reduced from 19 to 10 under the new law. In 22 of the 70 industries on the negative list, the actual proscription is limited to only a few of the many possible products within the standard industrial classification. For example, while the manufacture of biological products is on the negative list, only blood products are actually restricted.

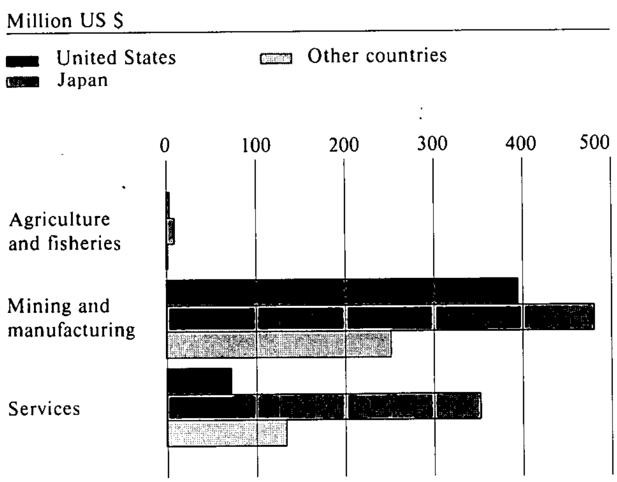
Almost half the industries closed to foreign investment are in agricultural processing, printing, and wood products. These businesses are primarily small and medium sized, and their continued protection reflects Seoul's dedication to this type of industry, as well as the political importance of the farm sector.

The emerging automobile- and truck-manufacturing sectors are protected from wholly owned foreign competition but are allowed access to foreign technology and marketing assistance through joint ventures. The infant semiconductor and computer industries, while theoretically free to acquire needed foreign capital and technology, may not be allowed to import high-technology capital goods and processes when domestically derived substitutes are available. We believe that this will not be a major restraint until South Korea's research and development capabilities improve. The technology-intensive sector receiving the greatest protection is telecommunications equipment, primarily optical fibers, which relies on licensing agreements for advanced technology. 25X1

Bureaucratic Procedures Altered

To reduce bureaucratic roadblocks, Seoul has instituted automatic approval procedures for investments under $1 million if the venture exports 60 25X1

South Korea: Cumulative Direct Foreign Investment Approvals by Industry and Country, 1962-83



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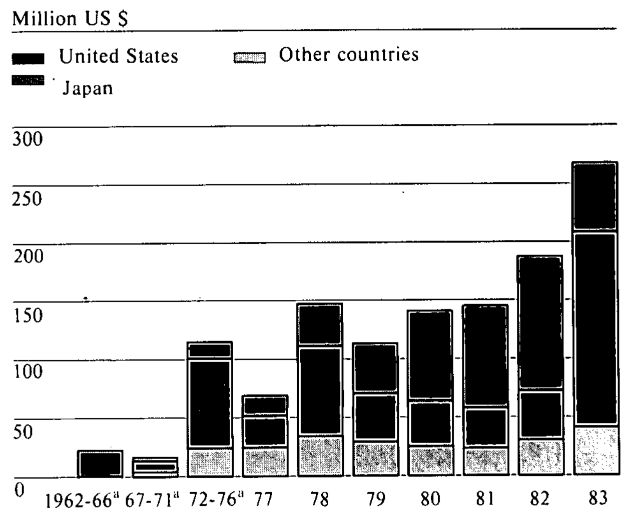
South Korea: Direct Foreign Investment, 1962-83



[a] Annual averages.

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percent or more of its product and has majority Korean ownership. The foreign equity restriction is waived if the products are free of import restrictions and are subject to a tariff of 10 percent or less. We estimate, however, that less than 10 percent of the value of US investments will qualify for automatic approval due to the large-scale nature and concentration in capital-intensive manufacturing of these investments.

Within the Economic Planning Board (EPB), a division has been established to coordinate foreign investment activities and eliminate delays and inconvenience. Authority to approve foreign investment continues to rest, however, with the Ministry of Finance (MOF).

The new rules reflect the conviction of many economic policy makers that foreign investment will bolster long-term growth by introducing crucial technology. Planners also have argued that increased foreign investment will reduce foreign borrowing requirements. Even though Seoul maintains a strong credit rating among international lenders, the global debt problem has hampered Seoul's ability to expand foreign borrowing. 25X1

Outlook for Direct Foreign Investment

We believe that the new FCIL represents a significant liberalization of foreign investment regulation and should result in increased foreign equity inflows. Many of the criticisms lodged against Seoul's handling of foreign investment have been addressed by the new regulations. For instance, removal of foreign equity restrictions should increase inflows of high-technology investments by giving foreign firms control over their proprietary products and processes. Weak patent protection 25X1 25X1

Selected Asian LDCs: Direct Foreign Investment, 1978-83 [a] *Million US $*

	1978	1979	1980	1981	1982	1983
South Korea	147.5	113.4	141.0	145.3	187.8	267.8
Singapore	359.9	387.0	573.7	625.0	545.4	604.0
Taiwan	136.7	181.5	243.4	356.3	320.3	NA
Indonesia [b]	405.2	318.6	346.6	379.0	449.9	246.9 [c]

[a] Commitment basis.
[b] Arrival basis. Excludes investment in hydrocarbons, banking, and insurance.
[c] Estimated.

[redacted] 25X1

and lax Korean attitudes toward contractual and licensing agreements have hampered high-technology inflows in the past. [redacted] 25X1

Although the new law also eliminates the automatic five-year tax holiday and subsequent three-year 50-percent tax reduction, this change should not have a major impact on foreign capital inflows. Special tax treatment is available for projects that augment import substitution or export promotion; have a high-technology component; or have large-scale capital requirements. Moreover, fewer than one-fifth of foreign investors considered the tax concessions to have been important in their decision to locate in Korea, according to an EPB study. Seoul reserves discretion in granting tax concessions and we believe tax relief will be available to investments in priority areas. [redacted] 25X1

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Morocco: Austerity and Education— Troubles Ahead

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Morocco's efforts to reform the expensive educational system is sparking fierce political debate and significantly increases the potential for student disorder in the coming school year. IMF and World Bank pressure to reduce costs in the education sector has convinced most Moroccan officials of the need to modify the system of free universal education. Convincing the average Moroccan family of this necessity, however, will test King Hassan's political skills. 25X1

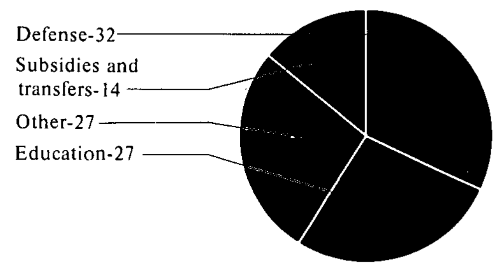
Background

Poor economic performance since 1979 has reduced government revenues and caused a decline in the standard of living. Unemployment is nearly 30 percent in urban areas. The country is now operating under a stiff austerity program and must proceed with major reforms to have continued access to IMF assistance. Morocco's educational system, which consumes over 27 percent of the administrative budget, is high on the list of IMF-suggested reforms. It is costly and cannot provide quality education or employment opportunities for the country's burgeoning, young population. 25X1

Educational facilities have not been able to cope with a student enrollment that has almost doubled in five years, according to the US Embassy. Despite the massive infusion of funds, overall literacy is only 28 percent. Wealthy Moroccans have opted for private education because public facilities have been swamped, focusing increased attention on the widening economic and social disparity between the Moroccan upper class and the rest of the country. 25X1

Morocco: Administrative Budget, 1983

Percent



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The Reform Program

Educational reform in Morocco has always been controversial, and student strikes protesting attempts to reduce educational services often have led to violence. Increased school fees were a major trigger for riots last January. More than half of Morocco's population is under 20 years old, and this adds to the sensitivity of the issue. 25X1

Morocco: Student Enrollment [a]

	1980/81	1985/86	1990/91
Total	**2,896,800**	**4,336,700**	**6,174,700**
Primary level	2,107,000	3,083,000	4,439,000
Secondary level	753,500	1,087,700	1,490,000
College level	36,300	166,000	245,700

[a] Figures do not reflect proposed education reform measures.

Morocco: University Enrollment by Discipline *Percent*

Law	45.2
Literature	28.5
Sciences	11.6
Medicine	8.7
Islamic Studies	4.6
Engineering	0.8
Teaching	0.6

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Under IMF pressure, the Ministry of Education last September limited the time any youth can spend in primary school. The average Moroccan student takes nine years to complete primary school, normally a seven-year curriculum. The US Embassy reports that the Ministry will limit the number of students eligible to take entry tests for both secondary schools and the nation's universities. This measure reportedly will bar 40,000 to 50,000 from higher education during the 1984-85 school year and reduce university enrollment by 20 percent.

the government toughened university entrance requirements in June to substantially reduce the number of students eligible to enter higher education this fall. The pass rate reportedly was 5 percent in the first examination session, but public outrage forced the government to be more lenient in the second session; the pass rate was 33 percent.

The Ministry of Education is considering even more comprehensive reforms to lower the cost of education. The number of new teaching positions will be slashed to 8,000 in 1984—down from an already reduced 15,000 new positions last year. Double shifts may be implemented to trim school construction costs. Fees for various educational services and examinations, university tuitions, and reduced housing stipends are also under discussion.

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Moroccanization of education is being promoted to reduce the number and influence of foreign teachers, whose salaries drain off as much as $30 million in scarce foreign exchange. Furthermore, Moroccanization will increase domestic employment.

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Efforts will be made to reorient higher education away from humanities toward technical disciplines. Rabat is pushing vocational training to absorb youth ineligible for higher education and to bring the education system more in step with Morocco's social and economic needs.

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Political Fallout

Many informed Moroccans agree that some reforms are necessary, but they are concerned about the political implications, according to the US Embassy. A senior education official points out that "the only thing the education system produces is unemployed university and high school graduates." A recent study by the socialist party claims that two-thirds of Morocco's 1983 college graduates are still without jobs.

Minister of Education Laraki's own Istiqlal (Independence) Party has disavowed his reform efforts, according to the US Embassy. The Istiqlal Party press stated that austerity measures do not justify "deprivation of children from school and the condemnation of hundreds of youth to unemployment and marginalization." The paper labeled education a "sacred and acquired right." The Communist Party press commended the Istiqlal position but remained critical of Istiqlal participation in formulating the regime's proposals.

The General Union of Moroccan Students has called for abolition of the government's reform plans. Parents reportedly have begun a campaign of protest letters to the Ministry of Education. A veteran politician in Casablanca warned that cuts in education are a potentially explosive move. The politician said that an unemployed constituent recently told him that he could tolerate food price increases because his relatives would assist, he could take unemployment because of the occasional odd job, and he could tolerate living in a slum. The constituent added, however, that if the regime took away education for his children he would be out on the streets demonstrating.

King Hassan is giving considerable attention to the reform issue. A major public information campaign is under way to allay anxiety over pending educational reforms. The King chaired a Cabinet meeting on the subject in June and reviewed a reform plan in July before talks with the IMF. In a speech on 8 July, Hassan told Moroccans "not to look down on vocational training" and extolled the virtues of the working class. 25X1

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Outlook

The recent Moroccan-Libyan union has raised public expectations of jobs in Libya and substantial financial assistance from Tripoli. This optimism may temporarily diffuse tensions over educational reforms and divert attention from Morocco's serious economic problems. Qadhafi's failure to deliver on past promises of assistance—especially on massive economic aid—suggests that he will fall short of his commitments. Any breach of the agreement would seriously aggravate Hassan's difficulty in containing unrest over educational and other unpopular financial reforms. 25X1

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Failure to make progress in reducing the cost of education—a major point of Morocco's program with the Fund—could jeopardize additional loans. Nevertheless, violent demonstrations later this year may cause the regime to reconsider school reforms and back away from educational austerity measures. 25X1

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Morocco's youth blame the regime for mismanagement of the economy and do not feel obligated to make sacrifices. Adding young people not returning to school this fall to the ranks of the unemployed will further aggravate popular restiveness over social conditions. Moreover, the deaths from hunger strikes of students arrested following riots last January could incite unrest on campuses over the coming school year. 25X1

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Ivory Coast: Coping With Financial Shortfalls

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The Ivory Coast probably will record its third consecutive year of declining GDP in 1984. Weak markets for major exports, mushrooming debt payments, public spending cuts, and shortages of vital imports probably will cause another drop in 1985, when President Houphouet Boigny must seek reelection. Although Houphouet recognizes the need to continue austerity, we believe that some slippage is likely, particularly on politically sensitive issues such as food prices, bus fares, and housing subsidies.

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Ivory Coast: Financial Indicators, 1980-84 *Million US $*

	1980	1981	1982	1983 [a]	1984 [b]
Trade balance	506	670	83	411	840
Exports (f.o.b.)	3,109	2,742	2,270	2,152	2,440
Of which:					
Cocoa	924	856	606	530	540
Coffee	681	485	504	441	680
Imports (c.i.f.)	2,603	2,072	2,187	1,741	1,600
Net services and transfers	−2,200	−1,888	−1,695	−1,567	−1,550
Of which:					
Interest on external public debt	−322	−375	−493	−547	−590
Salary remittances	−644	−563	−463	−388	−330
Current account balance	**−1,694**	**−1,218**	**−1,612**	**−1,156**	**−710**

[a] Estimated.
[b] Projected.

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Economic Woes

Ivory Coast's financial problems began in the early 1980s with the decline of coffee and cocoa prices and the burgeoning of debt obligations. By 1983, international bankers, already wary of Abidjan's growing debt service payments, backed away from any new lending. Ivory Coast began accumulating arrears. Amid rumors of impending large-scale defaults, the IMF and the French Government sought to assuage creditor uneasiness by pressuring Ivory Coast not to enter private capital markets for a planned $700 million, according to US Embassy reports. Without this bank financing Houphouet was forced to reduce imports and slash public expenditures.

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Austerity measures, especially cutbacks in government expenditures that reduced public-sector salaries and housing subsidies, hit Ivorians hard. GDP fell by at least 2 percent last year. Public investment—long the major engine of growth in Ivory Coast—was slashed by 25 percent, according to the US Embassy. Moreover, domestic banks faltered as central bank borrowings to finance the budget deficit drained them of monetary reserves that could not be replenished because of franc zone limitations on money creation.

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Abidjan's economic woes were compounded by widespread drought that hurt both domestic and export crop production. Large brush fires severely damaged many of Ivory Coast's agricultural plantations. As reservoirs for Abidjan's hydroelectric power dams dried up, electricity outages reached crisis proportions, causing many industrial plants to be shut down for long periods. Commercial and industrial activity declined by 25 to 30 percent compared with 1982, causing unemployment to rise substantially.

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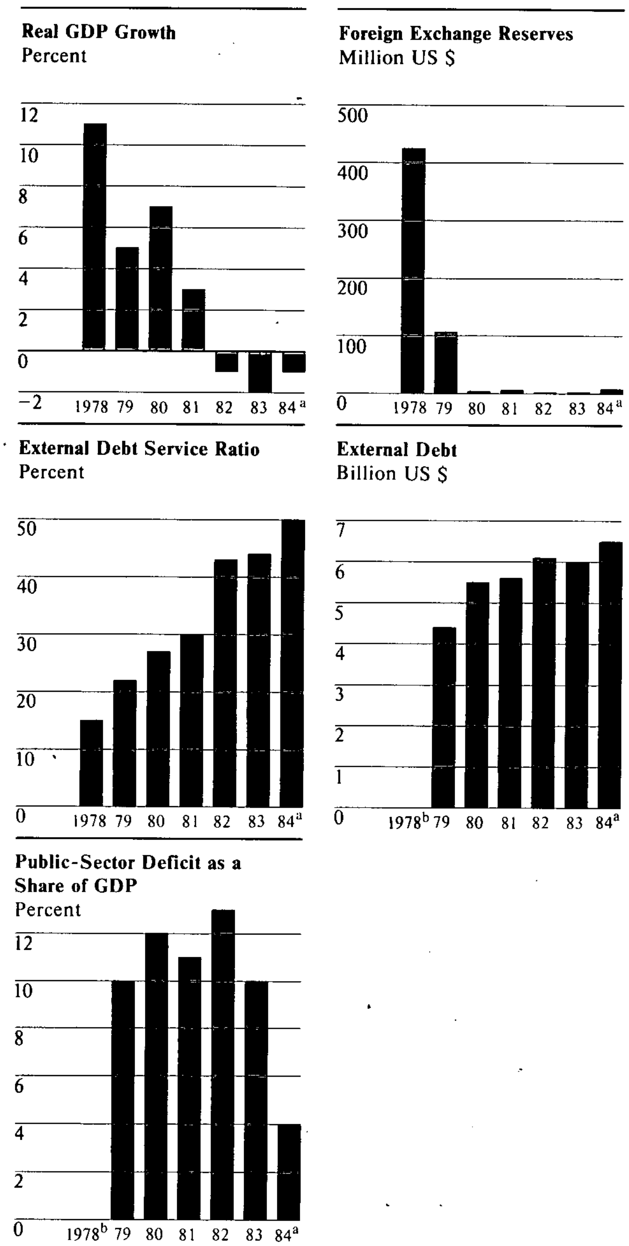
Ivory Coast: Economic Indicators, 1978-84



[a] Projected.
[b] Data not available.

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Houphouet Seeks Relief

Ivory Coast—now Sub-Saharan Africa's second-largest debtor after Nigeria—was forced this year to reschedule its $6.5 billion foreign debt. Principal payments on debt incurred since 1979—nearly half of Abidjan's total external obligations—were coming due in 1984, boosting estimated debt service obligations some 40 percent, to nearly $2 billion. A sharp rise in the value of the US dollar and in world interest rates helped push debt service to a projected 50 percent of export earnings. 25X1

Negotiations were prolonged and not until August was Abidjan able to complete the final steps to gain about $1 billion in financial relief from a combination of debt reschedulings, World Bank and IMF assistance, and new bank money:

- Abidjan reached agreement with the London Club steering committee in August to reschedule almost $550 million in 1984-85 principal payments.
- Commercial banks have agreed to provide $125 million in new money in 1984 and have indicated they may provide additional funding for 1985.
- Abidjan's commercial debt rescheduling closely followed a Paris Club rescheduling of $220 million in official debt and helped pave the way for disbursement of an $82 million IMF standby facility approved in May. 25X1

Even though President Houphouet has gained some maneuvering room, he will have to struggle to make ends meet. Payments arrears are still over $500 million, according to press reports, and the US Embassy reports that delays in payments to suppliers have slipped to nine months. The $125 million in new money from commercial banks falls far short of the nearly $400 million, two-year commitment that Houphouet had hoped to obtain. Consequently, Ivory Coast has had to arrange a $75 million prefinancing loan just to meet expenses during the coffee- and cocoa-growing season. Houphouet is counting heavily on the recent upswing in

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cocoa and coffee prices and a better-than-average seasonal rainfall to boost foreign exchange earnings this fall. We believe that the French are continuing to provide financial support to the government, but that President Mitterrand is making it clear to Abidjan that it must bear the brunt of the burden by further restricting public expenditures and adhering to IMF and World Bank–mandated reforms.

Domestic Repercussions

Despite the rise in agricultural output, sharp cutbacks in public expenditures and currency shortages have offset agricultural gains this year. Abidjan's IMF program calls for a reduction in the public-sector deficit from 10 percent in 1983 to 4 percent of GDP. In response, the government is canceling large investment programs including major road, rail, and hydroelectric projects. Industry is operating at only 30 to 40 percent of capacity, according to the US Embassy. In addition, local businessmen are not restocking rapidly dwindling inventories because of the lack of domestic bank financing, and many are closing down or laying off workers. Meanwhile, the US Embassy reports that many French companies are leaving and 500 foreign contracts are terminating this year because of the increasingly poor economic conditions.

Even though the political fallout from the recession has been minimal, the government remains alert to signs of trouble. Houphouet, who remembers the 1983 nationwide teacher strike caused by hikes in public housing rents, last month decided against imposing further price increases for bread, bus fares, and rents on nationally owned housing units. Recognizing that corruption has become a public issue, the regime is proceeding with unprecedented and well-publicized trials of some corrupt government officials. Relations between Ivorians and resident foreign Africans are becoming more openly strained. The latter are being blamed by the government for a surge in crime over the past several years and they have been unable to find jobs.

Outlook

Ivory Coast's economic malaise comes at an awkward moment—recurring crises caused by power outages, soaring prices, declining French investment, rising crime, and blatant corruption are converging at a time when Ivory Coast's political future is unsettled because of the country's unresolved succession question. President Houphouet— 25X1 the country's 78-year-old founding father and only president—has made it clear that he does not intend to designate a constitutional successor until after his reelection in October 1985. If Houphouet dies or becomes incapacitated before then, there is potential for a contentious and protracted power struggle. 25X1

Abidjan's foreign financial position is unlikely to improve much next year. An expected increase in export earnings caused by the upward trend in coffee and cocoa prices and a return to normal rainfall will not be enough to finance the country's minimum import and debt-servicing needs. Oil sales, once considered the hope of Ivory Coast, are unlikely to provide revenues in 1985 because of the failure to find major reserves. Meanwhile, private creditors are reluctant to lend large sums to Ivory Coast until it eases its debt burden. Abidjan's prospects, therefore, depend greatly on the government's ability to secure financial relief from bilateral and multilateral donors. 25X1 Within limits, we expect France to continue aid flows while pressing Houphouet to stick with his economic austerity program. On the brighter side, Abidjan probably will be able to reschedule a portion of its projected $2 billion 1985 debt obligation if the stabilization program meets IMF demands. 25X1

Cuts in public expenditures, tight money, and shortages of vital imported goods, however, will be required, contributing to a GDP decline of at least another 1 percent. Houphouet probably will attempt to avoid further controversy over housing

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costs before the election, especially since allegations of corruption in the industry have touched even the President's wife and sister, according to the US Embassy. Likewise, the President may ease up on his campaign to alleviate domestic banking strains that has involved cracking down on delinquent debtors, most of whom are prominent Ivorians. [redacted] 25X1

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